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The Conference Board

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Economic Times

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The Missing Business Cycle

Edgar R. Fiedler

Editor's Note

Welcome to *Economic Times*, a new publication from The Conference Board. Its aim is to bring you useful information and insights about where the economy is headed and the major policy issues under debate. To that end the publication will include the best analysis and interpretation we can find both within and outside the Board.

This month, in addition to the homegrown output, we include a colloquium on Rostenkowski's new deficit-closing proposal, Steve Roach's views about today's gut-wrenching cocktail-party issue (Is the price of my house headed south?), Adrian Dillon on inventories, and a sour verdict about fiscal politics from Don Conlan. In the "Conference Board Stat File" you will find charts of the key statistical series that were the mainstays of the *Statistical Bulletin* and several other publications, which *Economic Times* replaces. One of these series is new to us, the recession-risk calculation from the National Bureau of Economic Research.

We cordially invite your suggestions on how to improve *Economic Times*.

Maxim of the month:

*An economist's best friend
is his dogma.*

Recent signs and portents on the economy have been oscillating like a yo-yo. Some of this is just normal statistical noise, but lately the gyrations have been more pronounced than usual. The purchasing managers' index is up, housing is down. The trade balance strengthens, industrial production sags. On it goes. Every new statistic contradicts the one before. Overall, however, the economy just doesn't know where it wants to go.

The two most worrisome reports are the climb of long-term interest rates, which were already oppressively high, and the drop in consumer expectations, now partially recouped in March (*chart, p. 10*). The escalation of interest rates has to be taken seriously, but our inclination is to dismiss the retrenchment of consumer spirits as no more than a momentary reflection of the explosion of fuel-oil, fruit and vegetable prices caused by the deep December freeze. We regard it, in other words, as an event that will not put a lasting chill (pun intended, alas) on the free-spending habits of Americans. Thus far, happily, the 1990 retail sales data confirm that judgment.

Offsetting the adversities are several favorable developments. Business is still raising investment spending. The dollar is still low enough to give American producers a 5-10 percent advantage over foreign competitors, which should lead to further gains in our international accounts. Inventories continue to be well behaved, as Adrian Dillon points out elsewhere in this issue.

Whether the negatives outweigh the positives or vice versa, who knows? The guess here is that it's a Mexican stand-off. The economy is directionless.

That's not how the profession and the media are playing it, however. The rhetoric of the economic pundits says we are still fighting the same old cyclical battles. The optimists, whose forecasts for 1990 average near 2 percent growth and 4 percent inflation, speak warmly about soft landings and a sustained expansion at high levels of resource utilization. The pessimists, whose forecasts for 1990 average near 2 percent growth and 4 percent inflation, speak darkly of sluggish demand and stagnation. One even compared the economy to water torture.

One day in 1988, while I was in the men's room, the business cycle slipped out a side door and hasn't been heard from since.

What's out of place in this conventional discussion of the outlook is the continued emphasis on standard business cycle analysis. Such an approach is out of date. One day in 1988, while I was in the men's room, the business cycle slipped out a side door and hasn't been heard from since.

It'll be back! Sooner or later, when we're least expecting it, the cycle will reappear. But at the moment the business cycle is missing. Economic activity continues to expand gradually, with no inclination either to sag into recession or surge into boom. Similarly, the price indexes continue to rise at the accustomed rate, giving no sign of either quickening or moderating.

Consequently, there's little reason to be either an optimist or a pessimist about the economy, because for now at least the cyclical risks have all but vanished. It is in fact a rather dull state of existence.

Colloquium

Background:

Ways and Means Committee chairman Rostenkowski has proposed a 5-year deal to cut the budget deficit. His package includes higher taxes, and cuts in both defense spending and social benefits. The Democratic leadership says no deal without a major tax increase. The President is sticking with his no-new-taxes pledge but says let's talk.

Question:

Does budget gridlock still prevail or is there now a chance they will actually cut a deal?



Isabel V. Sawhill
The Urban Institute

Rostenkowski's political courage is refreshing and his plan is exactly the kind of everything-on-the-table compromise we badly need. But I doubt that there will be a deal. Neither the Democratic leadership nor the White House has endorsed the specifics of the plan. The approving noises emanating from the Administration are better understood as a tactical means of dividing the Democrats than as the precursor of a grand compromise.



Murray Weidenbaum
Center for the Study of American Business

Dan Rostenkowski merits a silver star for gallantry for coming up with a specific plan to reduce the deficit. Unfortunately, his approach to curbing the flow of red ink will wind up being just foolhardy.

The Administration seems to be humoring him in the hope that the tax-increase tarbaby becomes securely attached to the Democrats. Because they are also playing the reluctant dragon on cutting spending, I doubt that any deal will be made.

Members:

Members of The Conference Board Economics Colloquium are: Stephen H. Axilrod, Vice Chairman, Nikko Securities International; Andrew F. Brimmer, President, Brimmer & Company; Don R. Conlan, President, Capital Strategy Research; Robert G. Dederick, Executive Vice President and Chief Economist, Northern Trust Company; John T. Dunlop, Lamont University Professor Emeritus, Harvard University; Lyle E. Gramley, Senior Staff Vice President & Chief Economist, Mortgage Bankers Association; Isabel V. Sawhill, Senior Fellow, The Urban Institute; Charles L. Schultze, Director, Economic Studies Program, The Brookings Institution; James Tobin, Sterling Professor Emeritus, Yale University; Laura D'Andrea Tyson, Visiting Professor, Harvard University; Charles E. Walker, Chairman, Charles E. Walker Associates; Murray Weidenbaum, Director, Center for the Study of American Business; Albert M. Wojnilower, Senior Advisor, First Boston Corporation.



Robert G. Dederick
Northern Trust Company

It certainly is possible that this will be the year for the Grand Budget Compromise. It also is possible that the Cubs will meet the White Sox in the World Series. As I understand it, the President isn't opposed to the Rostenkowski initiative; he's just opposed to what's in it. And even that puts him a step ahead of the Congressional Democratic leadership. Somehow such muted enthusiasm does not appear to be the recipe for rapid progress. But, who wants progress in an election year anyway?



Charles E. Walker
Charles E. Walker Associates

The budget gridlock is not likely to be resolved until one or both of two things happens: a strong, popular President grasps the fiscal nettle and leads the battle for a major tax increase plus spending restraint, or voters finally perceive deficits as a threat to living standards and force their representatives to act. The Rostenkowski plan does not seem likely to lead to either requirement.

Surviving the Housing Crunch

By Stephen S. Roach

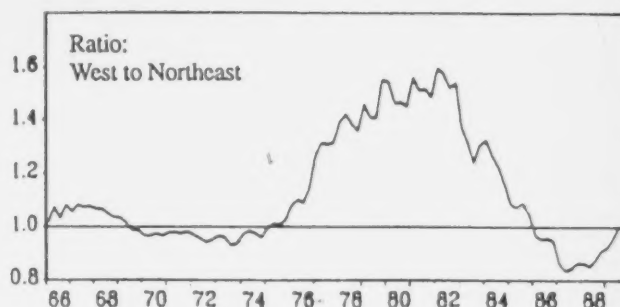
Concerns abound over the current softness in the housing market. Is there a real danger of a tumble in America's favorite asset play? How vulnerable is the U.S. economy to such an outcome?

Analysis

To begin with, housing prices are not collapsing. For the nation as a whole, the median price for existing homes rose about 4% in 1989 — little different from the 5% average gains over the past decade. Of course, the market has been very soft in the Northeast for well over a year. But this downshift is hardly suprising following a five-year period when home prices in this region essentially doubled by surging ahead at an unsustainable 16% rate per annum. To better gauge the balance of the regional disparities that have long been a way of life in the national housing market, we have examined recent changes in home prices for 83 localities — covering a broad cross section of the United States. It turns out that the widely publicized declines in the metropolitan areas of New York, Boston, Phoenix, and Detroit have been more than offset by impressive gains evident in the areas surrounding Chicago, Cleveland, upstate New York, and along the West Coast. And, for the remainder of the country, recent home price gains have been clustered in the 5% vicinity.

To be sure, in the 1980s, house price appreciation slowed dramatically from the double-digit pace of the late 1970s. But this should hardly be suprising in today's environment of relatively subdued inflation. The need was sharply diminished for housing to serve as a hedge against inflation's corrosive destruction of living standards — especially given the outstanding performance of financial assets in the 1980s and shifts in the tax code that raised

Relative Housing Prices



after-tax mortgage costs in excess of 40% for most families.

But, even if the unthinkable does happen and home prices experience a protracted and widespread downslide, the U.S. economy will survive. Vulnerability on this score will very much be determined by the integrity of the household balance sheet. Fortunately, the ratio of household sector net worth in homes relative to wealth in financial assets has fallen steadily in the 1980s and currently stands at about 25% — fully 20 percentage points below the highs at the beginning of the decade and almost completely retracing the gains of the 1970s.



Moreover, it turns out that over the course of the current expansion, only about 11% of the cumulative rise in household wealth since 1982 can be at-

tributed to rising net worth in housing — a far cry from the roughly 40% share that was evident in the two upturns of the 1970s. This outcome does not, of course, represent a conscious flight away from homeownership but, instead, simply reflects the sharp appreciation in the value of financial assets as juxtaposed against a more subdued appreciation of home prices. Thus, contrary to conventional wisdom, the 1980s have demonstrated that the economy's built-in mechanism for balance sheet protection is alive and well.

Strategic Implications

- As the Great Inflation was unwound, a slower rate of home price appreciation has emerged as one of the hallmarks of the current expansion — a trend that should endure in the 1990s.
- While geographic disparities occur frequently, the recent softening in Northeast home prices essentially brings this region back into rough alignment with the West — restoring equilibrium to the national housing market (see chart).
- Housing has made a minimal contribution to U.S. wealth generation in the 1980s — suggestive of a suprising resilience if real estate values sag unexpectedly.

Reprinted from *Morgan Stanley, Economic Perspectives*, January 1990.

Crosscurrents in Nationwide Home Prices

(Changes by Metropolitan Area From Third Quarter 1988 to Third Quarter 1989)

Down

Phoenix (-6.7%)
 Worcester, MA (-6.7%)
 New York City Area
 NY/NJ/CT (-4.7%)
 Oklahoma City (-4.1%)
 Saint Louis (-3.5%)
 New Haven/Meriden (-2.9)

New Orleans (-2.5%)
 Little Rock/N. Little Rock (-2.0%)
 Tulsa (-1.7%)
 Kansas City (-1.1%)
 Fort Lauderdale/Hollywood/
 Pompano Beach (-0.9%)
 Baton Rouge (-0.3%)

Boston (-0.3%)
 Detroit (-0.3%)
 Hartford (-0.2%)

Up 0 to 5%

San Antonio (+0.0%)
 Providence (+0.1%)
 Albuquerque (+0.1%)
 Salt Lake City/Ogden (+0.4%)
 Chattanooga (+1.1%)
 Philadelphia (+1.8%)
 Jacksonville (+1.8%)
 Minneapolis/St. Paul (+2.1%)

Pittsburgh (+2.1%)
 Memphis (+2.2%)
 Orlando (+2.3%)
 Wichita (+2.9%)
 Springfield, MA (+3.1%)
 Rochester, NY (+3.2%)
 Lexington/Fayette (+3.4%)
 Spokane (+3.5%)

Charleston, SC (+3.6%)
 Birmingham, AL (+3.9%)
 Toledo (+4.0%)
 Daytona Beach (+4.1%)
 Madison, WI (+4.2%)
 Greenville/Spartanburg (+4.2%)
 Miami/Hialeah (+4.8%)

Up 5 to 10%

Mobile (+5.0%)
 El Paso (+5.5%)
 Corpus Christi (+5.5%)
 Atlanta (+5.5%)
 W. Palm Beach/Boca Raton (+5.5%)
 Raleigh/Durham (+5.7%)
 Omaha (+5.8%)
 Milwaukee (+5.8%)
 Louisville (+5.9%)
 Knoxville (+5.9%)
 Columbia, SC (+5.9%)

Nashville/Davidson (+6.3%)
 Peoria (+6.3%)
 Syracuse (+6.4%)
 Akron (+6.4%)
 Dallas (+6.9%)
 Washington, DC (+7.0%)
 Baltimore (+7.2%)
 Montgomery, AL (+7.2%)
 Des Moines (+7.6%)
 Indianapolis (+7.9%)
 Lansing/E. Lansing (+7.9%)

Las Vegas (+8.2%)
 Houston (+8.2%)
 Cincinnati (+8.4%)
 Tampa/St. Petersburg/
 Clearwater (+8.7%)
 Denver (+9.1%)
 Columbus, Ohio (+9.1%)
 Fort Worth/Arlington (+9.5%)

Up 10% or More

Chicago (+10.5%)
 Portland, OR (+10.8%)
 Grand Rapids (+11.2%)
 Buffalo/Niagra Falls (+11.4%)
 Cleveland (+11.6%)
 Dayton/Springfield (+13.2%)

Charlotte/Gastonia/
 Rock Hill (+14.5%)
 Orange County (Anaheim/
 Santa Ana) (+14.6%)
 Sacramento (+16.3%)
 San Diego (+17.3%)

Riverside/San Bernadino (+17.4%)
 Albany/Schenectady/Troy (+17.7%)
 Los Angeles Area (+18.7%)
 Honolulu (+21.7%)
 Seattle/Tacoma (+22.5%)
 San Francisco Bay Area (+23.1%)

Source: National Association of Realtors and California Association of Realtors

Dillon on Optimism and Inventories



Adrian Dillon
Assistant Treasurer
and Chief Economist,
Eaton Corporation,
Cleveland

TCB Reporter: You have a reputation for chronic optimism about the economic outlook, isn't that so?

Dillon: Yes, but to be more precise it's not my optimism that's chronic, it's the rather steady expansion of the economy for 7 straight years now.

TCB: So you claim it's the other forecasters who keep calling for a recession that doesn't show up who, by contrast, give you a reputation as an inveterate optimist. Is that it?

Dillon: You're putting words in my mouth, and making enemies for me, but I guess that's more or less right.

TCB: And you're still optimistic for 1990? Why?

Dillon: Yes. There are several reasons but the most important is what the Federal Reserve has done. From January 1988 to April 1989 the Fed preemptively tightened monetary policy to cool off an overheated economy. They succeeded in preventing a new inflationary spiral from developing. Since then, just as deliberately, the Fed has been lowering short-term interest rates to prevent a cooling economy from head-

ing into the deep freeze of recession, and this too appears to be succeeding. Another reason is illustrated by the accompanying chart.

TCB: Interpret the chart for us, please.

Dillon: The chart is designed to give advance warning of inventory overbuilding. The first point is that inventories of nondurable goods are not a problem. They're virtually never a problem, in fact, because food, chemicals, paper and other nondurables get sold quickly after they're produced. Nobody holds much inventory of nondurables—only about one-month's supply on average.

TCB: So the trouble comes in durable goods?

Dillon: Yes, if there is a problem, you find it in the durable-goods sector.

TCB: Why do you exclude automobiles from your chart?

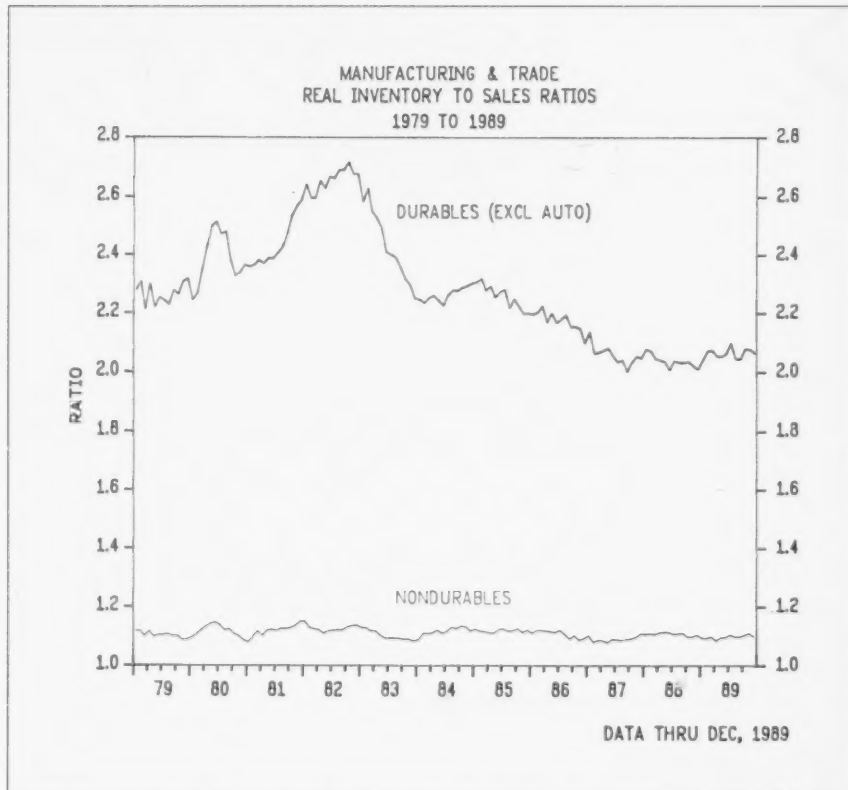
Dillon: The auto industry marches to a different drummer than other durable-goods industries, so you have to look at it separately.

TCB: Any problem now, either in autos or elsewhere?

Dillon: No. Autos had a problem until January, but they fixed it by cutting prices and production, so stocks are pretty much back in line. And as the chart shows, the rest of the sector has done a remarkably good job of keeping inventories under control. There is no reason at all to think that business will have to slash orders and production in order to bring inventories back into balance.

TCB: And thus no reason for you to stop being a cock-eyed chronic optimist?

Dillon: Yea, I'm not going to lose my reputation this year.



Auto Rebates and Turkish Bazaars

The jump in rebates on new cars over the past 6-9 months (*chart*) has often been interpreted as a signal of recession-like weakness in consumer demand. In our view this is much too pessimistic. What seems to be overlooked is that the rebates are simply a new way to set prices. We've always had list prices and dealer discounts and occasionally discounts from the manufacturers to the dealers. Now producer rebates paid directly to the buyer have become standard, adding still another more-or-less-permanent dimension to the structure of car prices. It's as confusing as a Turkish bazaar.

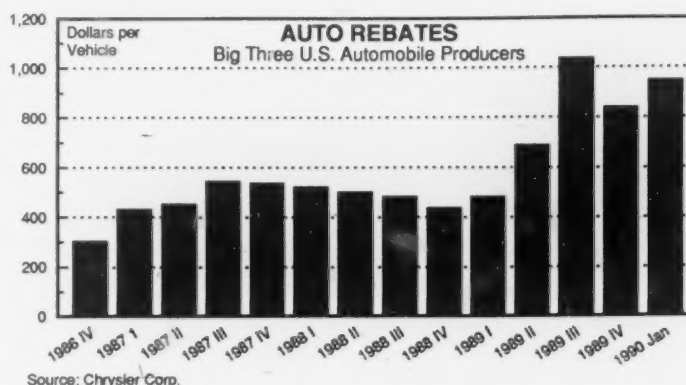
The purpose of the rebates is to stabilize demand and thereby keep costs down. The auto companies have learned from the Japanese how much more efficient it is to keep their assembly lines running at steady, high rates. So if sales lag behind production and current inventories get out of control, cutting prices can actually cost the company less than stopping and restarting an assembly line.

The boost in rebates could still be a response to weak consumer demand. But that's only one of many possibilities. An

increase in rebates could also come about because the manufacturers' sales expectations and thus production rates were too high to start with. Alternatively, rebates might have to be lifted if auto-price increases (to cover mandated safety improvements or for any other reason) depressed auto demand. In that situation the problem is car prices, not weak consumer demand. In any event, it's a tricky matter and often misleading to judge the strength of general consumer demand from the size of the auto rebates.

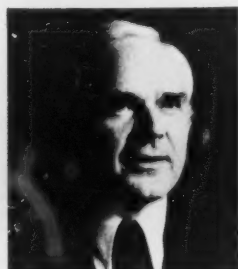
The best indicator, still, is sales volume. Total consumer spending con-

tinues to rise smartly. Within the industry, sales of autos and light trucks have been fairly steady for a couple of years now, down a little from the peak in 1986 but basically on trend. This suggests the auto market is in reasonably good shape but in the mature phase of the cycle. Thus, although we reject the idea that recent consumer demand for motor vehicles is "recession-like," neither has it been robust. What we are looking at, evidently, is a mature market that is doing OK but offers little growth potential for the economy.



Quotable Quote

February 1990



Don R. Conlan
Capital Strategy
Research, Inc.

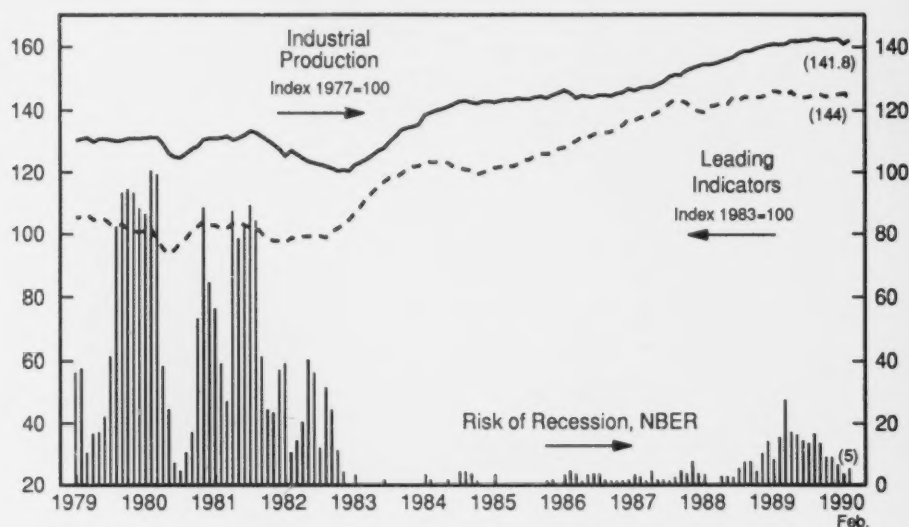
Thus far I have said nothing about U.S. fiscal policy for the reason that there is no fiscal policy, except by accident. It has become a political free-for-all with no one even embarrassed by the chicanery and everyone, including the Administration, playing games. Unless there is a significant social security tax reduction (Can you believe that it's being discussed?) the economic impact of fiscal policy will probably be neutral to moderately restrictive for most of this year, again by accident, of course. On the other hand, a large tax cut, while it would stimulate the real side of the economy, probably would devastate the financial side, coming, as it would, with no credible spending reductions. It would also disillusion foreign holders of U.S. dollar assets, to the detriment of the dollar. If we are as close to full labor force utilization as I think we are, additional artificial demand stimulation combined with a weaker dollar are not the stuff of price stability, and that should be thoroughly disconcerting to the Federal Reserve.

Conference Board Stat File

As the charts and forecasts on the next few pages reveal, the business cycle is still in forward gear, but at limited speed. Most encouraging, the calculation (*chart below*) by Mark W. Watson of Northwestern University and the National Bureau of Economic Research shows the risk of recession to be a minimal one in 20. Yet at the same time the leading indicators have been flat for a year. The Conference Board's help-wanted ad volume and the indexes of economic momentum (*next page*) are equally uninspiring. In sum, recent economic reports run the full range from tedium to apathy. (*Note: Data for Conference Board series in this section are available on request; please call Ken Goldstein at 212-339-0331.*)

Early Warning Indicators

*Economy drifting comfortably.
Recession chances remote.*



Help-wanted Advertising and Unemployment

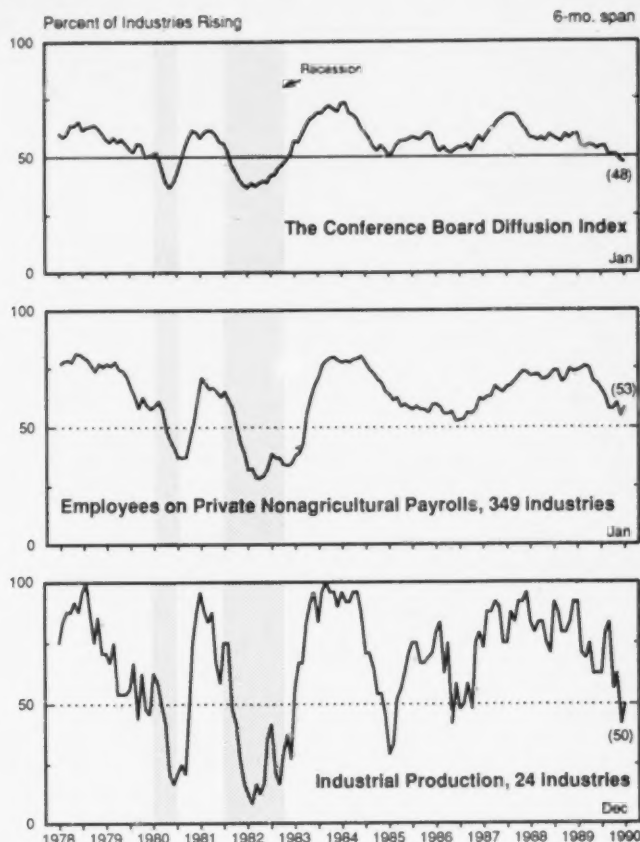
*Labor demand
a bit softer.*



Conference Board Stat File

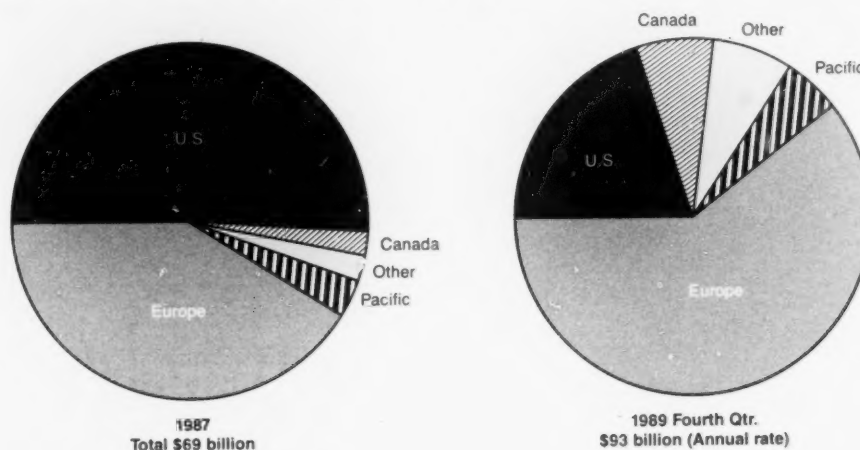
Indexes of Economic Momentum

Earlier momentum stalled, but not reversed.



Japanese Overseas Investors Turn from United States to Europe

Overseas Net Purchases of Stocks and Bonds by Japanese Long-Term Institutional Investors



Source: Japanese Securities Dealer Association.

Comment: The general stability of U.S. long-term interest rates over this 3-year span is a telling rebuke to those who foresaw financial-market disaster if and when the Japanese moved away from U.S. investments.

Conference Board Stat File

Confidence

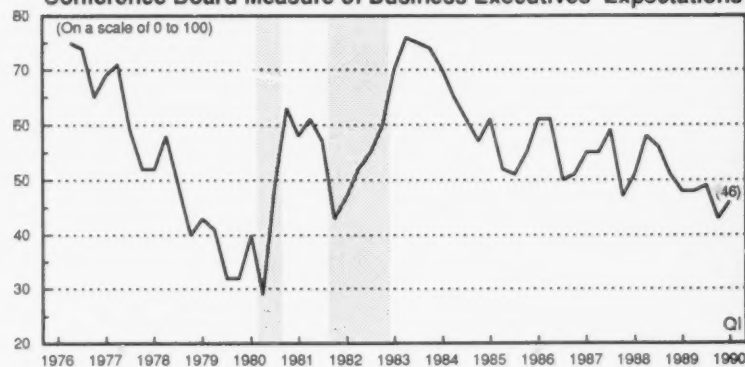
Consumers a little more uncertain.

Conference Board Consumer Confidence Index



Executive attitudes mixed but drooping.

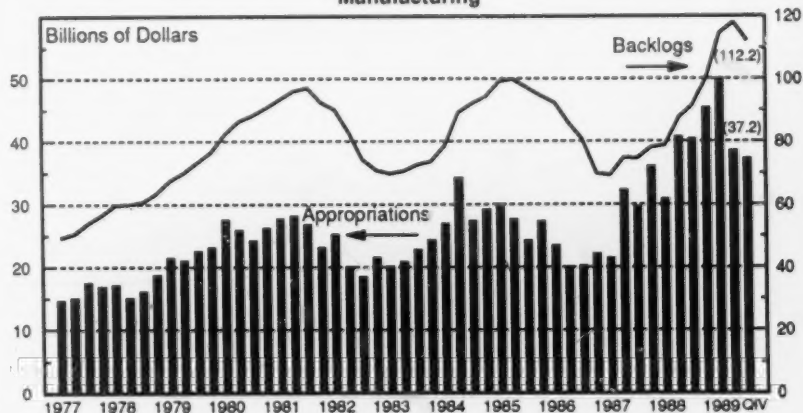
Conference Board Measure of Business Executives' Expectations



Investment Intentions

Expansion plans have eased a bit.

Conference Board Capital Appropriations
Manufacturing



Inside the Crystal Ball

Economic Forecasts

UCLA
MERRILL L.
DUPONT
GEORGIA ST.
CONF. BOARD
L.H. MEYER
DRI
WEFA

Date of Forecast Feb. Feb. Feb. Feb. Feb. Feb. Feb. Feb.

Gross National Product

(Quarter-to-quarter percent change, constant dollars, seasonally adjusted at annual rates)

		%	%	%	%	%	%	%	%		
Actual	1989 3Q	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3Q 1989	Actual
	4Q	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	4Q	
Forecast	1990 1Q	1.2	2.4	1.1	2.0	2.2	1.5	1.9	1.7	1Q 1990	Forecast
	2Q	1.7	2.7	1.2	1.9	2.2	2.2	2.6	2.1	2Q	
	3Q	2.1	2.3	2.0	2.4	2.6	2.0	2.3	2.4	3Q	
	4Q	1.8	1.5	2.4	2.8	2.8	1.8	1.9	2.5	4Q	
	1991 1Q	1.7	1.7	2.7	0.6	2.1	2.2	2.7	2.3	1Q 1991	
	2Q	1.8	2.3	3.0	1.4	2.3	3.3	2.6	2.6	2Q	
	3Q	2.0	2.2	3.2	2.1	2.8	2.2	2.3	2.4	3Q	
	4Q	2.2	2.3	3.5	2.3	3.4	2.4	2.0	2.6	4Q	
	1992 1Q	2.4						2.4	2.7	1Q 1992	

Inflation (GNP Deflator)

(Percent change from same quarter one year earlier)

Actual	1989 4Q	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	1989 4Q	Actual
Forecast	1990 4Q	4.3	4.4	4.0	4.1	3.6	4.1	3.6	4.2	1990 4Q	Forecast
	1991 4Q	4.0	4.2	3.9	4.1	4.0	4.1	3.9	3.9	1991 4Q	

Unemployment Rate

(Percent, quarterly)

Actual	1989 3Q	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3	3Q 1989	Actual
	4Q	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3	4Q	
Forecast	1990 1Q	5.5	5.3	5.3	5.3	5.3	5.3	5.3	5.3	1Q 1990	Forecast
	2Q	5.6	5.4	5.5	5.3	5.3	5.4	5.4	5.3	2Q	
	3Q	5.7	5.4	5.6	5.2	5.3	5.5	5.4	5.3	3Q	
	4Q	5.9	5.5	5.6	5.4	5.3	5.6	5.4	5.2	4Q	
	1991 1Q	5.9	5.5	5.6	5.5	5.3	5.7	5.4	5.2	1Q 1991	
	2Q	5.9	5.4	5.5	5.6	5.3	5.6	5.4	5.2	2Q	
	3Q	5.9	5.4	5.4	5.5	5.3	5.5	5.3	5.1	3Q	
	4Q	5.9	5.4	5.3	5.5	5.3	5.5	5.3	5.1	4Q	
	1992 1Q	5.9						5.3	5.1	1Q 1992	



The Conference Board
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